TAB 212

To Robin

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AHERF

Allegheny Health, Education and Research Foundation

D.L. Clark Building, 4th Floor
Pittsburgh, Pennsylvania 15212

Memorandum

TO: Al Adamczak
Vice President, Financial Services

FROM: Daniel J. Cancelmi
Senior Director, Corporate Accounting and Financial Reporting DC

DATE: July 3, 1997

SUBJECT: Delaware Valley Bad Debt Reserves

In my memorandum dated September 24, 1996, the status of the bad debt reserve balances was discussed (refer to Attachment A) At that time, old account balances of approximately $81 million were identified for possible writeoff against the reserve balances. The aging categories earmarked for possible writeoff were as follows

Entity	Aging Category	($ in 000s)	
Hahnemann	+ 365 days	$21,513	
	271- 365 days	7,050	28,563
MCPH	+ 365 days	9,940	
	211 - 365 days	6,927	16,867
St Christopher's	All PATCOM Accounts		18,329
Elkins	All PATCOM Accounts		9,690
Bucks	All PATCOM Accounts		8,003
			$81,452

As can be seen from the above aging categories, only rather old balances were identified for possible writeoff. No amounts were assigned for any account balances that were more current.

Based on the reserves that were available at that point in time, it was determined that sufficient reserves were available to cover the $81 million of accounts if they had to be written off However, the memorandum indicated that if all $81 million of reserves were used, we would be left with essentially zero bad debt reserves balances, which obviously would create a shortfall since the $81 million only included older account balances.

DEPOSITION EXHIBIT
1164
AKF

DBR-RS-0290

As you are aware, throughout fiscal 1997, all PATCOM account balances and other past statute accounts of approximately $80 million have been written off by Patient Accounting personnel. These accounts have been written off against the bad debt reserve accounts by General Accounting personnel so that the fiscal 1997 operating results would not be negatively impacted.

Subsequent to the decision being made to begin writing off $80 million of accounts ($20 million per quarter), a bad debt reserve methodology was developed for the Delaware Valley hospitals in order to promote consistency among the hospitals' reserve calculations. However, the required expense levels suggested by the reserve calculations (which approximated expense levels if calculated under the old reserve methods) were never recorded due to profitability concerns Rather, bad debt expense was recorded at the budgeted amounts on a monthly basis. Due to the continued deterioration of the aging categories and the consumption of the existing bad debt reserve balances to cover the $80 million of writeoffs, bad debt shortfalls were created and continued to grow throughout fiscal 1997.

In an effort to alleviate the bad debt shortfalls, Graduate reserves of $50 million were transferred to the Delaware Valley hospitals Despite the transfers of these reserves, a shortfall of approximately $25 million still existed as of May 31, 1997 as documented in my memorandum dated June 20, 1997 (refer to Attachment B). Since a shortfall still exists questions have arisen as to why a shortfall still prevails if $50 million of Graduate reserves have been transferred. The primary reasons can be summarized as follows:

- The level of bad debt expense ($32 7 million) and recoveries ($3 7 million) recorded throughout fiscal 1997 ($36 4 million in total) have only been sufficient enough to cover accounts written off to bad debts during fiscal 1997 by Patient Accounting ($36 1 million - this amount is over and above the $80 million of past statute and PATCOM accounts that have been written off)

- Despite the writeoff of $80 million of past statute and PATCOM - type accounts and $36 million of other bad debt writeoffs, the required bad debt reserve balances per the calculations indicate reserves of $67 6 million are still needed at May 31, 1997

- Unsubstantiated patient reserve adjustments of $10 8 million were recorded by General Accounting personnel in September 1996 to enhance operating results When these adjustments could not be substantiated, General Accounting covered these adjustments with bad debt reserves

An assessment of the total Delaware Valley fiscal 1997 allowance follows

	($ in 000s)
Fiscal 1997 bad debt expense	$32,663
Fiscal 1997 bad debt recoveries	3,679
Fiscal 1997 bad debt writeoffs	(36,094)
Net increase/(decrease) in reserves	248
Required reserves @ 5/31/97 per reserve calculations	67,857
Shortfall	(67,609)
Graduate reserves	50,000
General Accounting reserve adjustments	(10,752)
Adjusted Shortfall	$(28,361)

Refer to Attachment C for further analysis of this information by respective hospital

DBR-RS-0291

Attachment D to this memorandum further analyzes the bad debt reserve position as of June 30, 1996 rolled forward for fiscal 1997 activity through May 31, 1997.

Given the fact that a shortfall of approximately $25 million still exists of May 31, 1997, a proposal has been advanced to utilize various reserves in June 1997 to cover the shortfall. Assuming acceptance of such proposal, June 30, 1997 bad debt allowances will be supported by consistent detail calculations and no shortfall will be carried forward into fiscal 1998. In tandem with these proposed reserve transfers, I am proposing that we begin recording bad debt expense in June 1997 based on the reserve calculations instead of recording budgeted bad debt expense.

If you have any questions or need additional information, please contact me at your convenience.

Attachments

DJC/jaf
s/jodie/wp/dan/memos-sa/dv-bddbt.mem

cc. David McConnell
Joe Dionisio
Chuck Morrison
Greg Snow

Attachment A

AHERF

Allegheny Health, Education and Research Foundation

D.L. Clark Building, 4th Floor
Pittsburgh, Pennsylvania 15212

Memorandum

TO: Stephen H. Spargo
Senior Vice President, Corporate Support Services

FROM: Daniel J. Cancelmi
Senior Director, Financial Services /DC

DATE: September 24, 1996

SUBJECT: **Delaware Valley Accounts Receivable Reserves**

In my memorandum dated September 20, 1996, the status of the Delaware Valley aging categories was discussed. In short, since the aging categories continue to deteriorate, the monthly financial statement results continue to be burdened with levels of bad debt expense which exceed budgeted amounts Accordingly, we are continually faced with attempting to explain negative bad debt variances to operating unit personnel, which create a distraction for the operating units to focus on For obvious selfish reasons, we in Finance may want to reconsider our accounting treatment for addressing uncollectible accounts

I believe it is fair to state that there is a pool of old receivables that we will not be able to collect. The questions that all of us have been struggling with is how much is the amount of bad accounts and can we afford to write the accounts off. For almost a year, we have bled the accounts off or suffered the consequences of deteriorating aging categories, which has served to impair operating results. In turn, Finance has had to react to a barrage of inquiries from operating unit personnel Since their patience may be wearing thin, now may be the time to "bite the bullet" and write off accounts using existing bad debt reserves.

Certainly, upon the writeoff of the old accounts, our remaining reserves will be negligible. However, the strategy would be to build up the reserves over the remainder of fiscal 1997. Furthermore, for the foreseeable future, the operating units would not be burdened with the excess bad debt levels Essentially, assuming the billing and collection processes function as designed, the aging categories should not deteriorate to the point where we have to deal with a problem of the magnitude created by the patient accounting consolidation and system conversions.

As we have discussed in recent days, several options have been advanced to dispose of the old accounts. Based on accounts receivable data as of August 31, 1996 and the associated reserves, the following analysis is one option we may want to pursue to eliminate the old accounts

Refer to the following:

Proposed Inpatient and Outpatient Accounts to be Written Off

Entity	Aging Category	($ in 000s)	
Center City Hospital	365+	$21,513	
	271-365	7,050	
			28,563
East Falls Hospital	365+	9,940	
	211-365	6,927	
			16,867
	All PATCOM Accounts		
St. Christopher's	365+	10,260	
	<365	8,069	
			18,329
	All PATCOM Accounts		
Elkins Park Hospital	365+	5,547	
	<365	4,143	
			9,690
	All PATCOM Accounts		
Bucks County Hospital	365+	4,440	
	<365	3,563	
			8,003
Total Accounts to be Written Off			$81,452

Existing Reserves to be Used to Cover Writeoffs

♦ Bad debt reserves	Center City Hospital	$29,922	
	East Falls Hospital	7,457	
	St Christopher's	9,239	
	Elkins Park Hospital	3,707	
	Bucks County Hospital	3,542	
			53,867
♦ Other reserves segregated for bad debts @ 6/30/96			17,500
♦ AGH capitalized interest reserve			7,500
♦ Other reserves to be used			2,585
			$81,452

If the above approach is taken, we would be left with zero bad debt reserves as of August 31, 1996 However, budgeted Delaware Valley bad debt expense for the remainder of fiscal 1997 is approximately $29,700. Assuming any further writeoffs for the remainder of fiscal 1997 are not significant, we may be able to build the bad debt reserve back up in the $25 - $30 million range by June 30, 1997 Furthermore, any future collections on the accounts to be written off of $81,452 would also increase our bad debt reserve as of June 30, 1997.

DBR-RS-0294

There are certainly other options that can be pursued This is just one suggestion as to how we can put this problem behind us.

If you have any questions or need additional information, please contact me at your convenience.

DJC/jaf
s/jod/wp/dav/memos-ss/dv-artcs.mem

Attachment 8

AHERF

Allegheny Health, Education and Research Foundation

D.L. Clark Building, 4th Floor
Pittsburgh, Pennsylvania 15212

Memorandum

TO: Charles P. Morrison
Senior Vice President, Chief Financial Officer - DV

FROM: Daniel J. Cancelmi
Senior Director, Financial Services /DC

DATE: June 20, 1997

SUBJECT: **Delaware Valley Bad Debt Reserve Shortfall**

The following is a summary of the bad debt reserve shortfall as of May 31, 1997. It should be noted that the following estimated required bad debt reserve levels are predicated on the new reserve methodology that we have discussed in the past.

($ in 000s)

	Required Bad Debt Reserve As of May 31, 1997	Unadjusted General Ledger Bad Debt (Reserve) Debit	Unadjusted Shortfall	Graduate Reserves	Adjusted Shortfall As of May 31, 1997
Bucks County	$(4,592)	$3,955	$8,547	$(7,000)	$1,547
Elkins Park	(14,424)	(3,631)	10,793	(8,000)	2,793
Hahnemann	(32,533)	(11,427)	21,106	(10,000)	11,106
MCP	(20,509)	582	21,091	(15,000)	6,091
St. Christopher's	(9,899)	3,647	13,546	(10,000)	3,546
	$(81,957)	$(6,874)	$75,083	$(50,000)	$25,083

If you have any questions or need additional information, please contact me at your convenience

cc: David McConnell
Joe Dionisio
Al Adamczak
Greg Snow
Russ Laing
Chuck Lisman
Robin Schaffer

DBR-RS-0296

Attachment C

Allegheny University Hospitals
and St. Christopher's Hospital for Children

Analysis of Current Year Bad Debt Allowance
($ In 000s)

	A Current Year Bad Debt Expense	B Current Year Recoveries	C Current Year Writeoffs	(A+B+C=D) Net (Increase)/ Decrease In Reserve	E Required Reserves @ 5/31/97	(D-E=F) Current Year Shortfall	G Graduate Reserves	H General Accounting Revenue Adjustments	(F-G-H) Adjusted Current Year Shortfall
Allegheny University Hospitals*									
Hahnemann	($8,031)	($1,143)	$9,185	$11	($32,533)	$32,544	($10,000)	$6,782	$29,326
MCP	(12,818)	(1,283)	16,988	2,887	(15,509)*	18,396	(15,000)	1,113	4,509
Elkins Park	(2,543)	(284)	2,320	(507)	(5,324)**	4,817	(8,000)	1,072	(2,111)
Bucks County	(2,973)	(315)	3,058	(230)	(4,592)	4,362	(7,000)	188	(2,450)
St. Christopher's Hospital for Children	(6,298)	(654)	4,543	(2,409)	(9,899)	7,490	(10,000)	1,597	(913)
Total	($32,663)	($3,679)	$36,094	($248)	($67,857)	$67,609	($50,000)	$10,752	$28,361

* Excludes $5 million EPPI past statute writeoffs which will occur in June 1997

** Excludes Patcom past statute accounts receivable

DBR-RS-0297

ATTACHMENT D

Allegheny University Hospitals
and St. Christopher's Hospital for Children

Bad Debt Allowance Analysis
($ in 000s)

	Past Statute Accounts to be Written-off @ 6/30/96 *	Non Past Statute Accounts to be Reserved @ 6/30/96	Total Allowance Required @ 6/30/96	Actual Bad Debt Allowance @ 6/30/96	Bad Debt Allowance Deficiency @ 6/30/96
Hahnemann	$16,590	$23,653	$40,243	$34,810	$5,433
MCP	11,978	11 302	23,280	10 396	12,884
Elkins Park	9,100	2 402	11 502	4,196	7,306
Bucks County	7,823	2 201	10 024	3 826	6 198
St. Christopher's Hospital for Children	16 367	5 844	22,011	11 908	10,103
	$61,858	$45,202	$107,060	$65,136	$41,924

* Such amounts are net of related charge differentials

Analysis of Deficiency @ 5/31/97

	Actual Bad Debt Allowance @ 6/30/96	Actual Bad Debt Expense 11 mos ended 5/31/97	Actual Bad Debt Recoveries 11 mos ended 5/31/97	Reserved transferred from Graduate entities	Total Bad Debt Allowance Before FY97 Write-off	Write-off of Past Statute Accounts	Write-off of Non Past Statute Accounts & Gen'l Acctg Rev Adj	Bad Debt Allowance @ 5/31/97	Total Allowance Required @ 5/31/97	Bad Debt Allowance Deficiency @ 5/31/97
Hahnemann	$34,810	$8 031	$1 143	$10 000	$53,984	($16 590)	($15,967)	$21,457	$32 544	($11,087)
MCP	10,396	12 818	1 283	15 000	39 497	(11 978)	(18,101)	9,388	18 396	(9 008)
Elkins Park	4 196	2 543	284	8 000	15,023	(9,100)	(3,392)	2,531	4 817	(2,286)
Bucks County	3 826	2 973	315	7 000	14 114	(7,823)	(3,246)	3,045	4,362	(1,317)
St. Christopher's Hospital for Children	11 908	6 298	654	10,000	28,860	(16,367)	(6,140)	6,353	7,490	(1,137)
	$65,136	$32,663	$3 679	$50,000	$151,478	($61,858)	($46,846)	$42,774	$67,609	($24,835)

DBR-RS-0298

TAB 213

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AHERF

Allegheny Health, Education and Research Foundation

Suite 2900, Fifth Avenue Place
Pittsburgh, Pennsylvania 15222

MEMORANDUM

TO: Sherif S. Abdelhak
President and CEO

David W. McConnell
Executive Vice President and CFO

FROM: Stephen H. Spargo SHS
Senior Vice President, Corporate Support Services

DATE:: March 13, 1997

SUBJECT: Graduate Projections

The attached schedules are intended to demonstrate the likely operating results of the five Graduate hospitals during the presumed three month period (April 1 - June 30, 1997) that they may be part of AHERF. As you will note, these projections are based on the actual financial results for the most recently available three month period (which, in most cases, is November 1, 1996 - January 31, 1997). Although there may be some degree of risk in expecting the April-June results to replicate the financial performance of the November-January period, our past experience would suggest that the latter months of any given fiscal year are normally the most profitable. I have also reflected, where applicable, the following more noteworthy acquisition related adjustments:

- Medicare recapture proceeds at the rate of 25% of the estimated settlement amount, which, in addition to being somewhat conservative (which I believe is justified in anticipation of the fiscal intermediary's reaction), it allows us to recognize like amounts of additional net revenue over the ensuing three years.

- The elimination of all or a portion of depreciation expense consistent with the writedown of property and equipment (necessitated by the purchase price allocation).

- Potential (and hopefully, likely) expense savings estimated at 3% of salaries and benefits and 5% of purchased services and administrative and general costs. These expense reductions may be rather aggressive, but hopefully will materialize as efficiencies and cost savings opportunities are identified.

DEPOSITION EXHIBIT 1533 4/11/03

DBR-AA 41834

It should be noted that these projections do not include provisions for any restructuring or severance type costs, all of which will be recorded "below the line" while the hospitals are in SDN and Horizon. I should point out, however, that the reserves that are being established on the various hospitals' books while in SDN and Horizon (some of which are quite significant) will be immediately available upon transfer to AHERF to smooth out earnings, to offset unexpected revenue declines or expense overages, etc.

From a purely financial performance perspective, I would recommend that Graduate and Rancocas Hospitals be brought into AHERF on April 1, 1997 and, presuming that the forthcoming operating plans and identified cost savings are acceptable, that the other GHS hospitals be brought into AHERF on June 1, 1997. I hope these projections are helpful and would be happy to provide any additional information or clarification that may be desired.

SHS:dlg
Attachments
031397.2

EFFECT OF TRANSFERRING CERTAIN GRADUATE ENTITIES TO AHERF ON APRIL 1, 1997
(Dollars in Thousands)

	Projected Excess/(Deficiency) of Revenue over Expenses 3 Month Period April 1 - June 30, 1997	FY 97 Target	Difference
Graduate Hospital	$10,572	$8,000	$2,572
Mt. Sinai Hospital	(631)	-	(631)
Parkview Hospital	114	(500)	614
City Avenue Hospital	(951)	(500)	(451)
Rancocas Hospital	1,784	4,000	(2,216)
	$10,888	$11,000	($112)

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41836

GRADUATE HOSPITAL
STATEMENT OF REVENUE AND EXPENSES
for the three-month period November 1, 1996 - January 31, 1997
(Dollars in thousands)

	Actual	Acquisition Adjustments	3 Month Pro Forma
Revenue:			
Inpatient	$30,364	$6,250 (A)	$36,614
Outpatient	10,272	-	10,272
Sponsored projects	576	-	576
Investment income	2,123	-	2,123
Other	1,546	-	1,546
Total revenue	44,881	6,250	51,131
Expenses:			
Salaries, wages and fees	15,082	<500> (B)	14,582
Fringe benefits	2,946	<100> (B)	2,846
Patient care supplies	6,451	-	6,451
Purchased services	8,310	<400> (B)	7,910
Support & contract costs	2,123	-	2,123
Administrative and general	4,693	<200> (B)	4,693
Depreciation and amortization	2,916	<2,800> (C)	116
Interest	2,038	-	2,038
Total expenses	44,559	<4,000>	40,559
Excess of revenue over expenses, before restructuring costs	$ 322	$ 10,250	$ 10,572

(A) Represents 25% of the anticipated depreciation expense recapture proceeds of $25 million. It is expected that $6.25 million of these proceeds will be recognized annually from 1997-2000.

(B) Represents an estimate of the savings that the merger will yield as a result of efficiencies and economies within certain support and clinical areas (3% reduction in salaries and a benefits and 5% reduction in purchased services and A & G costs).

(C) Represents the anticipated reduction of depreciation expense as a result of the writedown of property and equipment in conjunction with the purchase price allocation.

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MT. SINAI HOSPITAL
STATEMENT OF REVENUE AND EXPENSES
for the three-month period November 1, 1996 - January 31, 1997
(Dollars in thousands)

	Actual	Acquisition Adjustments	Pro Forma 3 Month Actual
Revenue:			
Inpatient	$ 6,131	-	$ 6,131
Outpatient	232	-	232
Sponsored projects	-	-	-
Investment income	27	-	27
Other	643	-	643
Total revenue	7,033	-	7,033
Expenses:			
Salaries, wages and fees	3,884	<110> (A)	3,774
Fringe benefits	999	<20> (A)	979
Patient care supplies	169	-	169
Purchased services	817	<40> (A)	777
Support & contract costs	454	-	454
Administrative and general	468	<20> (A)	448
Depreciation and amortization	351	-	351
Interest	712	-	712
Total expenses	7,854	<190>	7,664
Deficiency of revenue over expenses, before restructuring costs	$ <821>	$ 190	$ <631>

(A) Represents an estimate of the savings that the merger will yield as a result of efficiencies and economies within certain support and clinical areas (3% reduction in salaries and benefits and a 5% reduction in purchased services and A & G costs.

(B) Represents the anticipated reduction of depreciation expense as a result of the writedown of property and equipment in conjunction with the purchase price allocation.

PARKVIEW HOSPITAL
STATEMENT OF REVENUE AND EXPENSES
For the Three-Month Period November 1, 1996 - January 31, 1997
(Dollars in Thousands)

	Actual	Acquisition Adjustments	Pro-Forma 3 Month Actual
Revenue:			
Inpatient	$9,299	$0	$9,299
Outpatient	2,898	0	2,898
Sponsored Projects	0	0	0
Investment Income	0	0	0
Other	331	0	331
Total Revenue	12,528	0	12,528
Expenses:			
Salaries, Wages and Fees	5,702	(170) (A)	5,532
Fringe Benefits	880	(25) (A)	855
Patient Care Supplies	1,397	0	1,397
Purchased Services	2,773	(140) (A)	2,633
Administrative and General	1,327	(70) (A)	1,257
Depreciation and Amortization	428	0	428
Interest	312	0	312
Total Expenses	12,819	(405)	12,414
Excess/(Deficiency) of Revenue over Expenses before Restructuring Costs	($291)	$405	$114

(A) Represents an estimate of the savings that the merger will yield as a result of efficiencies and economies within certain support and clinical areas (3% reduction in salaries and benefits and 5% reduction in purchased services and A&G costs).

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CITY AVENUE HOSPITAL
STATEMENT OF REVENUE AND EXPENSES
For the Three-Month Period November 1, 1996 - January 31, 1997
(Dollars in Thousands)

	Actual	Acquisition Adjustments	Pro-Forma 3 Month Actual
Revenue:			
Inpatient	$10,701	$0	$10,701
Outpatient	2,276	0	2,276
Sponsored Projects	0	0	0
Investment Income	0	0	0
Other	177	0	177
Total Revenue	13,154	0	13,154
Expenses:			
Salaries, Wages and Fees	6,503	(200) (A)	6,303
Fringe Benefits	1,366	(40) (A)	1,326
Patient Care Supplies	1,664	0	1,664
Purchased Services	2,472	(120) (A)	2,352
Administrative and General	1,434	(70) (A)	1,364
Depreciation and Amortization	681	0	681
Interest	415	0	415
Total Expenses	14,535	(430)	14,105
Excess/(Deficiency) of Revenue over Expenses before Restructuring Costs	($1,381)	$430	($951)

(A) Represents an estimate of the savings that the merger will yield as a result of efficiencies and economies within certain support and clinical areas (3% reduction in salaries and benefits and 5% reduction in purchased services and A&G costs).

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RANCOCAS HOSPITAL
STATEMENT OF REVENUE AND EXPENSES
for the three-month period October 1, 1996 - December 31, 1996
(Dollars in thousands)

	Actual	Acquisition Adjustments	Pro Forma 3 Month Actual
Revenue:			
Inpatient	$14,301	$1,000 (A)	$15,301
Outpatient	6,135	-	6,135
Sponsored projects	-	-	-
Investment income	252	-	252
Other	801	-	801
Total revenue	21,489	1,000	22,489
Expenses:			
Salaries, wages and fees	9,975	<300> (B)	9,675
Fringe benefits	1,449	<40> (B)	1,409
Patient care supplies	2,180	-	2,180
Purchased services	1,914	<40> (B)	1,874
Support & contract costs	588	-	588
Administrative and general	2,926	<60> (B)	2,866
Depreciation and amortization	1,292	<100> (C)	1,192
Interest	921	-	921
Total expenses	21,245	<540>	20,705
Excess of revenue over expenses, before restructuring costs	$ 244	$1,540	$ 1,784

(A) Represents 25% of the anticipated depreciation expense recapture proceeds of $4 million. It is expected that $1 million of these proceeds will be recognized annually from 1997-2000.

(B) Represents an estimate of the savings that the merger will yield as a result of efficiencies and economies within certain support and clinical areas (3% reduction in salaries and benefits and a 5% reduction in purchased services and A & G costs.

(C) Represents the anticipated reduction of depreciation expense as a result of the writedown of property and equipment in conjunction with the purchase price allocation.

TAB 214

Allegheny General Hospital

Consolidated

Financial

Statements

for the

year ended

June 30, 1996

Coopers &Lybrand

Coopers & Lybrand L.L.P.

a professional services firm

Report of Independent Accountants

To the Board of Trustees of
Allegheny General Hospital:

We have audited the accompanying consolidated balance sheet of Allegheny General Hospital as of June 30, 1996 and the related consolidated statements of operations, changes in net assets, and cash flows for the year then ended. These consolidated financial statements are the responsibility of Allegheny General Hospital's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Allegheny General Hospital as of June 30, 1996 and the consolidated results of its operations, changes in net assets and cash flows for the year then ended in conformity with generally accepted accounting principles.

As discussed in Note 2 to the consolidated financial statements, Allegheny General Hospital changed its method of accounting for contributions by adopting Statement of Financial Accounting Standards (SFAS) No. 116, "Accounting for Contributions Received and Contributions Made" and its method of reporting by adopting SFAS No. 117, "Financial Statements of Not-for-Profit Organizations," as well as its method of accounting for investments by adopting SFAS No. 124, "Accounting for Certain Investments Held by Not-for-Profit Organizations."

Coopers & Lybrand L.L.P.

Pittsburgh, Pennsylvania
September 11, 1996

ALLEGHENY GENERAL HOSPITAL

CONSOLIDATED BALANCE SHEET
June 30, 1996
(Dollars in Thousands)

ASSETS

Current assets:		
Cash and cash equivalents	$	2,447
Short-term investments		11,394
Assets limited or restricted as to use		3,957
Receivables:		
Patient accounts, less allowance for uncollectible accounts of $12,576		50,036
Grants and other		5,077
Inventories		10,045
Prepaid expenses		839
Total current assets		83,795
Assets limited or restricted as to use, net of current portion		181,691
Property and equipment, net		248,747
Due from affiliates		26,369
Other assets		25,760
Total assets	$	566,362

LIABILITIES AND NET ASSETS

Current liabilities:		
Accounts payable and accrued expenses	$	54,044
Deferred grant revenue		3,717
Current portion of long-term debt		7,023
Total current liabilities		64,784
Long-term debt, net of current portion		257,521
Deferred grant revenue		1,074
Other noncurrent liabilities		784
Total liabilities		324,163
Net assets:		
Unrestricted		227,876
Restricted:		
Temporarily		6,773
Permanently		7,550
Total net assets		242,199
Total liabilities and net assets	$	566,362

PR-BINDER-12-00691

The accompanying notes are an integral part of the consolidated financial statements.

ALLEGHENY GENERAL HOSPITAL

CONSOLIDATED STATEMENT OF OPERATIONS
For the year ended June 30, 1996
(Dollars in Thousands)

Unrestricted revenues, gains and other support:	
Net patient service revenue	$ 394,561
Research support	8,789
Investment income	23,291
Net assets released from restrictions used for operations	8,518
Other revenue	23,981
Total revenues, gains and other support	459,140
Expenses:	
Salaries, wages and fringe benefits	204,513
Materials, supplies and services	201,662
Depreciation and amortization	33,284
Interest	13,927
Unusual items	3,149
Total expenses	456,535
Net income, before change in accounting principles	2,605
Income from change in accounting principles	3,716
Net income	6,321
Transfers to affiliates, net	(14,158)
Transfers from deferred revenue	562
Net assets released from restrictions used for acquisition of property and equipment	1,091
Decrease in unrestricted net assets	$ (6,184)

PR-BINDER-12-00692

The accompanying notes are an integral part of the consolidated financial statements.

ALLEGHENY GENERAL HOSPITAL

CONSOLIDATED STATEMENT OF CHANGES IN NET ASSETS
For the year ended June 30, 1996
(Dollars in Thousands)

Unrestricted net assets:	
Net income	$ 6,321
Transfers to affiliates, net	(14,158)
Transfers from deferred revenue	562
Net assets released from restrictions used for acquisition of property and equipment	1,091
Decrease in unrestricted net assets	(6,184)
Temporarily restricted net assets:	
Adjustment from change in accounting principles	1,213
Contributions	2,529
Investment income	1,767
Net assets released from restrictions	(11,350)
Unrealized appreciation of investments	639
Decrease in temporarily restricted net assets	(5,202)
Permanently restricted net assets:	
Contributions	655
Increase in permanently restricted net assets	655
Decrease in net assets	(10,731)
Net assets, beginning of year	252,930
Net assets, end of year	$ 242,199

PR-BINDER-12-00693

The accompanying notes are an integral part of the consolidated financial statements.

ALLEGHENY GENERAL HOSPITAL

CONSOLIDATED STATEMENT OF CASH FLOWS
For the year ended June 30, 1996
(Dollars in Thousands)

Cash flows from operating activities:	
Change in net assets	$ (10,731)
Adjustments to reconcile change in net assets to net cash provided by operating activities:	
Adjustment from change in accounting principles	(4,929)
Depreciation and amortization	33,284
Amortization of bond discount	81
Net transfers to affiliates	14,158
Net unrealized appreciation of investments	(443)
Gain on sale of property and equipment	(7,439)
Income from equity investments	(4,779)
Increase/(decrease) in cash from changes in:	
Short-term investments	(1,331)
Patient accounts receivable	17,923
Other receivables	(2,770)
Inventories	(614)
Prepaid expenses	(210)
Accounts payable and accrued expenses	18,292
Due to/from affiliates	(26,265)
Other	(22,960)
Net cash provided by operating activities	1,267
Cash flows from investing activities:	
Acquisition of property and equipment, net	(34,209)
Proceeds of sale of property and equipment	27,400
Decrease in assets limited or restricted as to use, net	30,527
Net cash provided by investing activities	23,718
Cash flows from financing activities:	
Repayments of long-term debt	(8,763)
Net transfers to affiliates	(14,158)
Net cash used by financing activities	(22,921)
Net increase in cash and cash equivalents	2,064
Cash and cash equivalents, beginning of year	383
Cash and cash equivalents, end of year	$ 2,447
Supplemental disclosure:	
Cash paid for interest	$ 14,747

PR-BINDER-12-00694

The accompanying notes are an integral part of the consolidated financial statements.

ALLEGHENY GENERAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 1996
(Dollars in Thousands)

1. <u>Organization:</u>

Allegheny General Hospital (AGH) is a Pennsylvania nonprofit charitable organization that operates a 777-bed tertiary care facility and an 80-bed subacute hospital-based skilled nursing facility. AGH is the parent company of Allegheny-Singer Research Institute (ASRI). AGH and ASRI comprise an obligated group formed in connection with the issuance of hospital revenue bonds. ASRI is a nonprofit medical research institute that receives funding principally from affiliates, government grant programs, and private donors.

Allegheny Health, Education and Research Foundation (AHERF), a nonprofit organization, is the parent company of AGH. AHERF is also the parent company of Allegheny University of the Health Sciences (Allegheny University), Allegheny University Hospitals, St. Christopher's Hospital for Children (St. Christopher's), Diversified Health Group, Inc. (DHG), Allegheny Integrated Health Group (AIHG) and Allegheny Health Services Providers Insurance Company (AHSPIC).

2. <u>Accounting Policies:</u>

The significant accounting policies applied in preparing the accompanying consolidated financial statements are summarized below:

<u>Principles of Consolidation:</u>

The accompanying consolidated financial statements include the accounts of AGH and ASRI. All intercompany transactions have been eliminated in consolidation.

<u>Accounting Changes:</u>

In fiscal year 1996, AGH adopted Financial Accounting Standards Board Statements (FAS), No. 116, "Accounting for Contributions Received and Contributions Made," No. 117, "Financial Statements of Not-for-Profit Organizations" and No. 124, "Accounting for Certain Investments Held by Not-for-Profit Organizations." FAS 116 requires that unconditional promises by donors to pledge monies to AGH be recorded as receivables and revenues within

ALLEGHENY GENERAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 1996
(Dollars in Thousands)

2. Accounting Policies: (continued)

the appropriate net asset category. FAS 117 establishes uniform standards for general-purpose external financial statements of not-for-profit organizations and further requires the classification of net assets into three categories, based on the existence or absence of donor-imposed restrictions as follows:

Unrestricted - Net assets that are not subject to donor-imposed stipulations. Such net assets may be designated by the Board of Trustees for specific purposes or limited by contractual agreements with outside parties.

Temporarily Restricted - Net assets whose use is subject to donor-imposed stipulations that can be fulfilled by specific actions pursuant to such stipulations or expire by the passage of time.

Permanently Restricted - Net assets subject to donor-imposed stipulations that neither expire by passage of time nor can be fulfilled and removed by action. Such net assets, which must be maintained in perpetuity, generally include only the original amount of the contribution since the donors of these assets most often permit the use of all investment earnings for specific or general purposes.

FAS 124 requires that investments in equity securities with readily determinable fair value and all investments in debt securities be reported at fair value with gains and losses included in the consolidated statement of operations. As is permitted by FAS 124, the cumulative effect of adopting the statement for periods prior to July 1, 1995 is $3,716 for unrestricted investments, which is reflected as an adjustment from change in accounting principle on the consolidated statements of operations, and $1,213 for investments temporarily restricted and is reflected on the consolidated statement of changes in net assets.

ALLEGHENY GENERAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 1996
(Dollars in Thousands)

2. Accounting Policies: (continued)

Use of Estimates:

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements. Estimates also affect the amounts reported as revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents:

Cash and cash equivalents include highly liquid investments purchased with a maturity date of three months or less and deposits maintained with AHERF which are available to AGH.

Investments and Investment Income:

A majority of AGH's short-term investments and those investments temporarily restricted by donors for specific purposes are managed pursuant to a master trust arrangement (Master Trust) that includes the investments of other AHERF entities. Investments in the Master Trust consist primarily of government and corporate obligations and repurchase agreements collateralized by U.S. Treasury notes and bonds that have fixed rates of return. Investment income and gains or losses are allocated on the pro rata cost value of each entity's investment. AGH's pro rata share of Master Trust is stated at fair value.

AGH's investments are carried at fair value and consist generally of investments similar to those in the Master Trust and marketable equity securities of domestic companies.

Donated investments are recorded at estimated fair value at the date of contribution. Unrestricted investment income and gains and losses on sales of investments, which are based on average cost, are included in investment income.

ALLEGHENY GENERAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 1996
(Dollars in Thousands)

2. **Accounting Policies:** (continued)

Grants Receivable and Deferred Grant Revenue:

Grants and contracts are recognized in the year in which expenditures are made, either as research support or, in the case of expenditures for property and equipment, as additions to net assets. Receivables are recorded when contract and grant expenditures exceed funds received. Deferrals are recorded when funds received are in excess of expenditures incurred. Additionally, notices of federal and other research grant awards relating to future years have not been recorded.

Inventories:

Inventories are valued at the lower of average cost or fair value.

Property and Equipment:

Property and equipment, along with expenditures that extend the useful lives of assets, are recorded at cost. Certain internal computer software and development costs are capitalized and included in property and equipment. Interest is capitalized in accordance with the construction of major capital additions. Maintenance and repairs are charged to expense as incurred. At the time assets are retired or otherwise disposed of, the cost thereof and the related accumulated depreciation or amortization are eliminated and any resulting gain or loss on disposition is recorded as other revenue.

Depreciation is provided over the estimated useful lives of the assets computed under the straight-line method with one-half year of depreciation recognized in the year the related assets are placed into service.

Other Assets:

Other assets consist primarily of bond financing costs, equity investments and investments in other joint ventures. Bond financing costs are being amortized over the respective terms of the related bond issues on a basis that approximates the interest method. AGH has a 32.3% ownership interest in Gateway Health Plan, L.P. (Gateway). AGH's share of income from its Gateway investment for fiscal year 1996 was $4,919.

ALLEGHENY GENERAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 1996
(Dollars in Thousands)

2. Accounting Policies: (continued)

Restricted Net Assets:

Temporarily restricted net assets are those whose use has been limited by donors for a specific purpose or a specific time period. Permanently restricted net assets have been restricted by donors to be maintained in perpetuity. Temporarily restricted assets released from restriction during the period are reflected in the consolidated statement of operations.

Net Patient Service Revenue:

AGH has agreements with third-party payors that provide for payments to AGH at amounts different from its established rates. Payment arrangements include prospectively determined rates based on discharges, discounted charges, per diem payments and capitation arrangements. Net patient service revenue is reported at the estimated net realizable amounts due from patients, third-party payors, and others for services rendered, including estimated net retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Charity Care, Uncompensated Care and Other Community Services:

AGH maintains a charity care policy which was established to assure that all persons seeking treatment receive needed health care services regardless of their ability to pay. This policy provides that persons who lack the means to pay for all or a portion of their needed health care services receive financial assistance in the form of partial or total charge reductions. Because AGH does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. The amount of charges forgone for services and supplies furnished under AGH's charity care policy approximated $3,615 in fiscal year 1996.

ALLEGHENY GENERAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 1996
(Dollars in Thousands)

2. Accounting Policies: (continued)

Additionally, AGH provides services to patients covered by Medical Assistance and Medicare, whereby the payments received are less than the costs of providing such services. Also, AGH performs services at no charge which benefit the community, such as public health screenings, health care publications, workplace wellness programs, health related research, educational programs and other activities.

Related Party Transactions:

Fees charged for services provided by affiliates are included in expenses with all other transactions among affiliates recorded as net asset transfers. Any resulting amounts due to or from affiliates are settled periodically in the normal course of business.

Income Tax:

AGH and ASRI are not-for-profit corporations that have been recognized as tax exempt pursuant to Section 501 (C)(3) of the Internal Revenue Code.

3. Assets Limited or Restricted as to Use:

Assets limited or restricted as to use consist of the following components at June 30, 1996:

Unrestricted:	
By Board of Trustees:	
Future additions or replacement of property and equipment	$ 151,298
By Financing Agreements:	
Debt service funds	3,960
Construction fund	12,332
	16,292
Endowments	3,723
	171,313
Temporarily restricted:	
By donor-specific purposes	6,095
Endowments	690
	6,785

ALLEGHENY GENERAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 1996
(Dollars in Thousands)

3. **Assets Limited or Restricted as to Use:** (continued)

Permanently restricted:	
Endowments	7,550
Total assets limited or restricted as to use	185,648
Less current portion	3,957
Assets limited or restricted as to use, net of current portion	$ 181,691

The following table sets forth the composition of assets limited or restricted as to use by investment type at June 30, 1996:

Unrestricted:	
Cash and short-term investments	$ 72,153
Government and corporate obligations	58,282
Marketable equity securities	40,878
	171,313
Temporarily restricted:	
Cash and short-term investments	506
Government and corporate obligations	2,633
Marketable equity securities	3,646
	6,785
Permanently restricted:	
Cash and short-term investments	144
Government and corporate obligations	3,007
Marketable equity securities	4,399
	7,550
Assets limited or restricted as to use	$ 185,648

The Board of Trustees retains control over certain designated assets and may, at its discretion, subsequently use such assets for other purposes. Assets limited or restricted as to use that are required to satisfy obligations classified as current liabilities, are reported as current assets on the consolidated balance sheet.

Investment returns consisted of the following for the year ended June 30, 1996:

Net gains on investments	$ 10,114
Dividends and interest	8,124
	$ 18,238

PR-BINDER-12-00701

ALLEGHENY GENERAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 1996
(Dollars in Thousands)

4. **Property and Equipment:**

Property and equipment consists of the following components at June 30, 1996:

Buildings and building improvements	$ 274,116
Equipment	195,789
Land and land improvements	10,482
	480,387
Less accumulated depreciation and amortization	246,648
	233,739
Construction in progress	15,008
Property and equipment, net	$ 248,747

5. **Lines of Credit:**

AGH maintains a $25,000 working capital line of credit from a bank. Interest on outstanding borrowings is based on one of several interest rate options that can be selected by AGH and there is a commitment fee of .08% on the unused portion of the available line. No borrowings were outstanding under the line of credit as of June 30, 1996.

6. **Long-Term Debt:**

Long-term debt consists of the following obligations at June 30, 1996:

Allegheny County Hospital Development Authority (ACHDA):	
Series 1995 A and B Hospital Revenue Bonds:	
A net of unamortized discount of $450 (with maturity dates through September 1, 2020 and fixed interest rates ranging from 4.65% to 6.35%)	$ 49,550
B (with maturity dates through September 1, 2020 and variable interest rates ranging from 2.8% to 5.0% during fiscal year 1996 and at 3.25% on June 30, 1996)	50,000
	99,550
Series 1993 A-C Notes:	
A (with maturity dates through July 1, 2012 and variable interest rates ranging from 5.57% to 6.35% during fiscal year 1996 and at 5.76% on June 30, 1996)	27,500
B (with maturity dates through January 1, 2012 and a fixed interest rate of 7.85%)	13,825
C (with maturity dates through January 1, 2004 and a fixed interest rate of 7.33%)	12,797
	54,122

ALLEGHENY GENERAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 1996
(Dollars in Thousands)

6. **Long-Term Debt:** (continued)

Series 1988 A-D Hospital Revenue Bonds (with maturity dates through March 1, 2018 and variable interest rates ranging from 2.75% to 5.0% during fiscal year 1996 and at 3.3% on June 30, 1996)	48,100
Pennsylvania Higher Educational Facilities Authority (PHEFA): Series 1991 A Revenue Bonds, net of unamortized discount of $677 (with maturity dates through September 1, 2017 and fixed interest rates ranging from 5.9% to 7.25%)	55,272
Term loan (with a maturity date of June 16, 1999 and variable interest rates ranging from 5.84% to 6.84% during fiscal year 1996 and at 5.84% on June 30, 1996)	7,500
	264,544
Less current portion of long-term debt	7,023
Long-term debt	$ 257,521

Redemption of all ACHDA obligations is supported by renewable irrevocable bank letters of credit. All obligations are subject to early redemption at the option of AGH. Additionally, under the provisions of the Master Trust Indenture, AGH is directly obligated to make loan payments related to the 1993 Bonds, 1991 Bonds, and 1995 A and B Bonds and is obligated to make rental payments under lease and sublease arrangements related to the 1988 Bonds, which are sufficient to enable the PHEFA and the ACHDA to make timely payments of principal and interest. These bonds are collateralized by the pledge of AGH unrestricted receivables to the Master Trustee. Additionally, AGH has entered into a Letter of Credit, Reimbursement and Security Agreement related to Series 1993 A and 1998 Bonds which contain specific covenants, the most restrictive of which require AGH to maintain unrestricted net assets of at least $200,000 and a long-term debt service coverage ratio of 1.2 or greater, calculated at the end of each quarter.

Following are scheduled principal repayments and sinking fund requirements on the long-term debt for each of the next five fiscal years:

1997	-	$7,023
1998	-	7,568
1999	-	15,537
2000	-	8,422
2001	-	9,134

ALLEGHENY GENERAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 1996
(Dollars in Thousands)

7. **Commitments:**

AGH leases certain medical and office equipment and office space used in its operations. Rental expenses for operating leases for the fiscal year ended June 30, 1996 were $12,359. The annual and total future minimum lease payments under noncancelable operating leases entered into as of June 30, 1996 are as follows:

Year	
1997	$ 8,595
1998	7,956
1999	7,056
2000	6,508
2001	6,171
2002 and thereafter	43,988
Total minimum payments	$ 80,274

8. **Net Patient Service Revenue:**

Net patient service revenue consists of the following components for the year ended June 30, 1996:

Gross patient service revenue	$ 849,990
Less provisions for contractual adjustments	455,429
Net patient service revenue	$ 394,561

Contractual adjustments represent the difference between standard billing rates and amounts estimated to be paid under various health benefit agreements. Provisions for contractual adjustments are recorded in the period in which the services are provided.

During fiscal year 1996, AGH's bad debt expense amounted to $16,874, which is included in materials, supplies and services expense on the consolidated statement of operations.

9. **Insurance:**

AHERF is self-insured for primary coverage and for certain levels of excess coverage related to professional and general liability claims through AHSPIC, an affiliated captive insurance company incorporated in the Cayman Islands. In addition, AHERF participates in the Medical Professional Liability Catastrophic Loss Fund of the Commonwealth of

ALLEGHENY GENERAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 1996
(Dollars in Thousands)

9. Insurance: (continued)

Pennsylvania (CAT Fund) and maintains insurance under commercially insured programs on a claims-made basis for amounts in excess of the self-insurance and CAT Fund coverages. Premiums paid by AHERF to AHSPIC are retrospectively rated and are based on funding requirements determined by independent insurance actuaries to include provisions for estimates of the ultimate costs for both reported claims and claims incurred but not reported, determined on a discounted basis using a 7.5% rate. Professional and general liability expense is allocated by AHERF to each relevant AHERF entity based principally upon such entity's reported claims and estimated claims incurred but not reported. During fiscal year 1996, total professional and general liability insurance expense was $283.

AHERF is also self-insured for workers' compensation liability claims and has established a trust fund for the payment of such claims. Funding requirements and estimates of losses incurred are determined on a discounted basis using actuarial assumptions which include a 6.0% discount rate and which are subject to revision based upon actual experience. Workers' compensation expense is allocated by AHERF to each relevant AHERF entity based principally upon such entity's reported claims and estimated claims incurred but not reported. During fiscal year 1996, AGH's workers' compensation expense was $5,025.

10. Pension Plans:

AHERF maintains a noncontributory, defined benefit pension plan covering substantially all AGH employees. Under this cash balance plan (the Plan), pension accruals are determined using a defined percentage of an employee's current compensation based on the employee's age and years of service. Each employee's individual retirement benefit is defined within the Plan's obligation as a notational cash balance retirement account and is credited with interest based on a defined interest rate. AHERF's funding policy is to contribute such amounts as are necessary on an actuarial basis to provide the Plan with assets sufficient to meet benefits to be paid to retirees or their beneficiaries and to satisfy the minimum funding requirements of the Employee Retirement Income Security Act of 1974. Pension expense is allocated by AHERF to each relevant AHERF entity based principally upon the number of full and part time employees covered by the Plan and their respective salary levels. During fiscal year 1996, AGH's pension expense was $6,012.

ALLEGHENY GENERAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 1996
(Dollars in Thousands)

10. Pension Plans: (continued)

AHERF sponsors a contributory, defined contribution savings plan which is available to substantially all AGH employees in order to provide additional security during retirement by creating an incentive for employees to make regular contributions on their own behalf. Under this plan, and as determined on an individual employee basis, AHERF contributes amounts equal to 25% of an employee's contribution for employee contributions up to 4% of such employee's salary in a given year. Such expense is allocated by AHERF to each relevant AHERF entity based on actual contributions made. AGH's expense associated with contributions to this savings plan was $1,135 for the year ended June 30, 1996.

11. Related Party Transactions:

An affiliation agreement between AHERF and Allegheny University stipulates certain AHERF financial commitments, in order to, among other things, strengthen Allegheny University's academic, research and health service programs. Such financial support of operations, which is determined annually based upon Allegheny University's needs and available funds within the AHERF system, is recorded as a net asset transfer on the consolidated statement of changes in net assets. In this regard, AGH, through AHERF, transferred $2,500 to Allegheny University during fiscal year 1996. AGH provided Allegheny University with a research grant, which is determined annually based upon the amount of external, competitively awarded research funds obtained by Allegheny University during the prior fiscal year and the total amount of internal funding available for research within the AHERF System. This research grant amounted to $3,571 in fiscal year 1996. Additionally, during fiscal year 1996, AGH purchased directly from Allegheny University $20,028 of physician administrative and teaching services and researcher services and initiated charges to Allegheny University of $3,492 for support and administrative services. The amounts purchased from Allegheny University are included in materials, supplies and services expenses, while the amounts charged to Allegheny University are included in other revenue on the consolidated statement of operations. During fiscal years 1996, AGH transferred $19,847 to AHERF to support corporate initiatives as net asset transfers on the consolidated statement of changes in net assets. AHERF provides selected management, administrative and support services to its operating units and charges them for these services. During fiscal year 1996, AGH

ALLEGHENY GENERAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 1996
(Dollars in Thousands)

11. **Related Party Transactions:** (continued)

incurred service charges from AHERF of $36,749 which are included on the consolidated statement of operations as materials, supplies and services. Additionally, AHERF is committed to advancing the quality of health care services provided to the communities it serves through the sponsorship of human genetic and biomedical research. Funding provided to AGH in this connection, which is reflected as net asset transfers on the consolidated statement of changes in net assets, amounted to $18,565 for the fiscal year ended June 30, 1996. AHERF also provided $868 in fiscal year 1996 to AGH as matching support related to externally funded contributions for the establishment of endowments. Such were recorded as other revenue on the consolidated statement of operations.

During fiscal year 1996, AGH, through AHERF, transferred $10,376 to AIHG to support its acquisition and operation of physician practices. This transfer has been reflected as a net asset transfer on the consolidated statement of changes in net assets. Prior to fiscal year 1996, support of AIHG's operations was provided through expense subsidization, which was reflected as an expense on the consolidated statement of operations as opposed to a net asset transfer.

12. **Functional Expenses:**

AGH provides general health care services through its hospital and performs medical research through its research institute. Expenses related to these services are as follows for the year ended June 30, 1996:

Health care services	$ 353,885
Medical research	21,891
General and administrative	80,759
	$ 456,535

ALLEGHENY GENERAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 1996
(Dollars in Thousands)

13. **Concentrations of Credit Risk:**

AGH grants credit without collateral to its patients, most of whom are local residents insured under third-party payor agreements. The mix of receivables from patients and third-party payors is as follows at June 30, 1996:

Medicare	34%
Medicaid	12
Blue Cross	16
Managed care	14
Other third-party payors	19
Patients	5
	100%

14. **Fair Value of Financial Instruments:**

The following methods and assumptions were used by AGH in estimating the fair value of its financial instruments:

Cash and cash equivalents: The carrying value reported in the consolidated balance sheet for cash and cash equivalents approximates its fair value.

Short-term investments: The carrying value reported in the consolidated balance sheet for short-term investments approximates its fair value.

Assets limited or restricted as to use: These assets consist primarily of government and corporate obligations, marketable equity securities, cash and short term investments and AGH's prorata share of the Master Trust. For government and corporate obligations and marketable equity securities, fair values were determined based on quoted market prices and dealer quotes where available, or quoted market prices pertaining to similar securities where not available. The carrying value for cash and short-term investments and for investments included in the Master Trust approximates fair value. The carrying value reported in the consolidated balance sheet for all assets limited or restricted as to use approximates their fair value.

ALLEGHENY GENERAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 1996
(Dollars in Thousands)

14. Fair Value of Financial Instruments: (continued)

Long-term debt: The fair value of all obligations included in long-term debt is based on current traded values. The carrying and fair values of AGH's long-term debt obligations are $264,544 and $268,415, respectively, at June 30, 1996.

15. Legal Matters:

AGH is subject to legal proceedings and claims which have arisen in the ordinary course of its business and have not yet been adjudicated. The ultimate liability from these actions cannot be determined because of the uncertainties that exist. In the opinion of management, the eventual disposition of these matters will not have a material adverse effect on the consolidated financial position of AGH. However, it is possible that, upon settlement, results of operations in a particular period could be materially affected.

16. Unusual Items:

AGH recognized expenses principally associated with reductions in workforce in fiscal year 1996. These expenses, which were $3,149, are classified as unusual items on the consolidated statement of operations.

Coopers
&Lybrand

Coopers & Lybrand L.L.P.

a professional services firm

Report of Independent Accountants on Consolidating Financial Information

Our report on the audit of the consolidated financial statements of Allegheny General Hospital as of June 30, 1996, and for the year then ended appears on Page 1. This audit was conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The supplementary consolidating financial information accompanying the consolidated financial statements is not necessary for fair presentation of the consolidated financial position, results of operations and changes in net assets of Allegheny General Hospital in conformity with generally accepted accounting principles. The supplementary consolidating financial information is presented only for purposes of additional analysis and is not a required part of the consolidated financial statements. The supplementary consolidating financial information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the consolidated financial statements taken as a whole.

Coopers & Lybrand L.L.P.

Pittsburgh, Pennsylvania
September 11, 1996

ALLEGHENY GENERAL HOSPITAL

CONSOLIDATING BALANCE SHEET
as of June 30, 1996
(Dollars in Thousands)

	AGH	ASRI	Consolidated AGH
		ASSETS	
Current assets:			
Cash and cash equivalents	$ 1,737	$ 710	$ 2,447
Short-term investments	6,455	4,939	11,394
Assets limited or restricted as to use	3,957	-	3,957
Receivables:			
Patient accounts, net	50,036	-	50,036
Grants and other	2,350	2,727	5,077
Inventories	10,045	-	10,045
Prepaid expenses	833	6	839
Total current assets	75,413	8,382	83,795
Assets limited or restricted as to use, net of current portion	169,423	12,268	181,691
Property and equipment, net	235,252	13,495	248,747
Due from affiliates	25,128	1,241	26,369
Other assets	24,406	1,354	25,760
Total assets	$529,622	$ 36,740	$566,362

	AGH	ASRI	Consolidated AGH
		LIABILITIES AND NET ASSETS	
Current liabilities:			
Accounts payable and accrued expenses	$ 50,768	$ 3,276	$ 54,044
Deferred grant revenue	-	3,717	3,717
Current portion of long-term debt	7,023	-	7,023
Total current liabilities	57,791	6,993	64,784
Long-term debt, net of current portion	257,521	-	257,521
Deferred grant revenue	-	1,074	1,074
Other noncurrent liabilities	784	-	784
Total liabilities	316,096	8,067	324,163
Net assets:			
Unrestricted	209,647	18,229	227,876
Restricted:			
Temporarily	2,315	4,458	6,773
Permanently	1,564	5,986	7,550
Total net assets	213,526	28,673	242,199
Total liabilities and net assets	$529,622	$ 36,740	$566,362

ALLEGHENY GENERAL HOSPITAL

CONSOLIDATING STATEMENT OF OPERATIONS
For the year ended June 30, 1996
(Dollars in Thousands)

	AGH	ASRI	Consolidated AGH
Unrestricted revenues, gains and other support:			
Net patient service	$394,561	$ -	$ 394,561
Research support	-	8,789	8,789
Investment income	22,960	331	23,291
Net assets released from restrictions used for operations	6,838	1,680	8,518
Other revenue	22,168	1,813	23,981
Total revenues, gains and other support	446,527	12,613	459,140
Expenses:			
Salaries, wages and fringe benefits	195,809	8,704	204,513
Materials, supplies and services	185,632	16,030	201,662
Depreciation and amortization	31,233	2,051	33,284
Interest	13,919	8	13,927
Unusual items	3,149	-	3,149
Total expenses	429,742	26,793	456,535
Net income/(loss), before change in accounting principles	16,785	(14,180)	2,605
Income from change in accounting principles	3,716	-	3,716
Net income/(loss)	20,501	(14,180)	6,321
Transfers (to)/from affiliates, net	(33,629)	19,471	(14,158)
Transfers from deferred revenue	-	562	562
Net assets released from restrictions used for acquisition of property and equipment	81	1,010	1,091
Increase/(decrease) in unrestricted net assets	$ (13,047)	$ 6,863	$ (6,184)

TAB 215

ALLEGHENY HEALTH, EDUCATION & RESEARCH FOUNDATION
AUDIT COMMITTEE
Pittsburgh, Pennsylvania

A meeting of the Audit Committee of Allegheny Health, Education & Research Foundation was held on Wednesday, October 15, 1997, at 12:50 p.m. in the Board Room of Allegheny General Hospital, Pittsburgh, Pennsylvania. The meeting was called pursuant to notice duly given in accordance with the Bylaws to each member of the Committee. A copy of the notice is appended to the original minutes of this meeting. The following individuals were present:

Members Present	Other Invitees	Members Absent
J. David Barnes	Sherif S. Abdelhak	Robert M. Hernandez
Ralph W. Brenner, Esq.	William F. Buettner (Coopers & Lybrand)	Graemer K. Hilton
Anthony M. Cook	Carol Gordon	Thomas H. O'Brien
Douglas D. Danforth	Lynn R. Isaacs	David W. Sculley
Richard H. Daniel	Donald Kaye, M.D.	
Harry R. Edelman, III	David W. McConnell	
Ira J. Gumberg	Leonard L. Ross, Ph. D.	
W. P. Snyder III	Barry H. Roth	
W. Bruce Thomas	Anthony M. Sanzo	
	Diane K. Schreccengost	
	Nancy A. Wynstra, Esq.	

I. Opening of Meeting

The meeting was called to order by J. David Barnes, Chairman. Nancy A. Wynstra, Esq. kept the minutes. The Chairman declared that a quorum was present and the meeting was competent to proceed.

II. Additions to the Agenda

Mr. Barnes noted there were no additions to the agenda.

DEPOSITION EXHIBIT
2019
AKF

GOV 55811

III. Approval Items

A. Minutes from the Meeting Held on March 14, 1997

The minutes from the meeting held on March 14, 1997 were reviewed. Upon motion duly made and seconded, the Audit Committee of Allegheny Health, Education and Research Foundation approved the following resolution:

> **RESOLVED, that the Audit Committee of Allegheny Health, Education and Research Foundation approves the minutes from the meeting held on March 14, 1997, as presented.**

B. Management Discussion and Report on Fiscal Year 1997 Audited Financial Statements and Related Reports for AHERF

David McConnell reported that audited financial statements for AHERF were presented along with the debt compliance verification letter for each outstanding debt obligation requiring annual verification. He noted that AHERF management has elected to present one consolidated set of financial statements (with consolidating schedules that identify the financial data of the separate entities) for the year ended June 30, 1997, in lieu of separate audit reports for the various AHERF entities. The reasons for preparing one set of consolidated financial statements can be summarized as follows:

- Given the vast and complex nature of AHERF's integrated system, one consolidated external reporting presentation portrays a more accurate picture of the financial condition/resources of the AHERF system, as opposed to presenting disparate financial snapshots of individual business units within AHERF's system.

- Stakeholders in the AHERF system (e.g., employees, debt holders, management, Board members) are provided a global financial overview of the financial status of the overall AHERF system, which AHERF's Board members and management have worked diligently to develop over the past decade.

- During fiscal 1997, AHERF realized substantial external audit cost savings (in terms of real dollars and audit efficiencies) and alleviated

certain internal administrative burdens by deploying a consolidated reporting methodology.

- A recently issued authoritative accounting pronouncement promulgates that separate obligated group financial statements prepared for debt purposes are no longer considered as prepared in accordance with generally accepted accounting principles. Accordingly, Coopers & Lybrand would be unable to issue a "clean opinion" on such statements. Rather, a "special purpose" opinion would have to be issued; such a change may prove alarming or confusing to our debt holders. In addition, the distribution of such statements would be greatly limited by the special purpose opinion, which restricts use to only management and specified parties. Accordingly, this would preclude the general distribution of the statements.

William F. Buettner noted that the audit work was completed on September 4, 1997, however, the Report of Independent Auditors was not signed. Management is waiting for official waivers from Graduate System bond trustees related to debt covenant violations. It was anticipated when the Graduate acquisition was consummated in November, 1996 that certain Graduate System hospitals would be in violation of debt service coverage ratio requirements for Fiscal Year 1997 as a result of approximately $49 million in restructuring charges (primarily non-cash), which do not impair the ability of the hospitals to meet future debt service requirements. When the waiver from the Trustees is received, the final report will be issued with an October date.

Mr. Buettner discussed the acquisition of the Graduate Hospital and certain accounting methodology that affected the financial statements. The mergers have been accounted for under the purchase method with the purchase price being the amount of the respective hospital's outstanding liabilities assumed by AHERF at the date of acquisition. The purchase price of the acquisitions has been allocated based on the fair value of the assets acquired and liabilities assumed. The operations of the acquired hospitals have been included in the accompanying consolidated financial statements from their respective dates of acquisition. The unaudited pro forma financial information presents the results of operations of the acquired hospitals as if the acquisitions had occurred at the beginning of Fiscal Year 1997 and the balance sheet information of the acquired hospitals at the respective acquisition dates.

A discussion followed regarding the amount of $367 million in Accounts Receivable, having achieved 62 net days of patient revenue. Because the collection of such large dollar amounts from the insurers is beyond the capability of their computer systems, negotiations continue in an effort to collect lump sum payments. Following discussion regarding the outstanding balances in Accounts Payable and expected adjustments which are intended to repay the AGH Funded Depreciation account, and upon motion duly made and seconded, the AHERF Audit Committee recommended that the Board of Trustees of Allegheny Health, Education and Research Foundation consider the following resolution:

> RESOLVED, that the Allegheny Health, Education and Research Foundation Board of Trustees approves the Audited Financial Statements and the related debt compliance letters for Fiscal Year 1997, as presented, subject to sign-off by Coopers & Lybrand; and
>
> FURTHER RESOLVED, that the Board instructs the Secretary to append copies of the accepted Fiscal Year 1997 Financial Statements and related debt compliance letters to the original minutes of this meeting.

C. <u>Fiscal Year 1997 Report on AHERF Internal Controls</u>

William F. Buettner reported that Coopers & Lybrand had reviewed internal controls within AHERF and its Obligated Group entities and stated that there were no matters noted during the audits that would be considered to be material weaknesses in the internal control structure. The letter reporting on the absence of material weaknesses, presented herein in draft form, is being provided to enable AHERF and its affiliates to comply with Medicare regulations requiring that such reports be included as an attachment to the Medicare Cost Report. All prior year comments made by Coopers & Lybrand have been adequately addressed by management. Upon motion duly made and seconded, the AHERF Audit Committee recommended that the Board of Trustees of Allegheny Health, Education and Research Foundation approve the following resolution:

> RESOLVED, that the Allegheny Health, Education and Research Foundation Board of Trustees accepts the Coopers & Lybrand Report on Internal Controls as presented; and

FURTHER RESOLVED, that the Board instructs the Secretary to attach a copy of the Report to the original minutes of this meeting.

IV. Information and Discussion Items

A. Coopers & Lybrand Management Letter and AHERF Management Response

David W. McConnell noted that the detailed Coopers & Lybrand management letter provided AHERF with system-wide internal control observations. The report is designed to provide focus areas for the CEOs in identifying opportunities for improved operations. William Buettner stated that the letter was provided to suggest enhancements to the control environment within AHERF, and he reiterated that no material control weaknesses were identified by Coopers & Lybrand during its audits. A brief discussion ensued regarding system corrections which were implemented to enhance revenue, and Mr. Buettner noted that a dramatic improvement had been made in the quality of registration input. It was noted that the repetition of low impact focus areas from year to year indicates that the management team has been diligent.

B. Coopers & Lybrand Required Communication to the Audit Committee

Mr. Buettner reported that the American Institute of Certified Public Accountants (AICPA) requires external auditors to communicate certain matters to their audit clients on an annual basis, and this letter is provided in compliance with such requirement.

C. Report on Fiscal Year 1997 Audited Financial Statements - Canonsburg General Hospital and Subsidiaries

Mr. Buettner noted that the audited financial statements for Canonsburg General Hospital were provided as information.

D. Coopers & Lybrand Management Letter and Canonsburg General Hospital Management Response

Mr. Buettner stated that the letter was provided as information to management and there were no material control weaknesses identified by Coopers & Lybrand during its audit.

E. Review of Audit Services Activities from March, 1997 to Present (Pittsburgh and Delaware Valley)

Diane Schrecengost reported that summary reports of all Audit Services audits and/or reviews were provided for information, and there were no significant issues to be brought to the attention of the Committee. Ms. Schrecengost noted that the department has been focusing on compliance issues, particularly in view of the emphasis from government agencies on fraud and abuse.
Ms. Schrecengost stated that risk assessment would be addressed at the March meeting, during which there will be time for questions from the Committee.

Executive Session

The offer of Executive Session was made to the representative of Coopers & Lybrand, and the offer was declined.

The offer of Executive Session was also extended to Audit Services, and the offer was declined.

The offer of Executive Session was made to management, and the offer was accepted. Mr. Buettner was excused from the meeting.

Recommendation of Appointment of External Auditors

Mr. McConnell presented management's recommendation that the Audit Committee recommend to the AHERF Board that Coopers & Lybrand be reappointed to serve as external auditors for AHERF and its subsidiary organizations for Fiscal Year 1998. Mr. McConnell noted that management would report to the Audit Committee at its next meeting on the result of management negotiations with Coopers & Lybrand regarding audit fees. He noted further that although Coopers & Lybrand had recently merged with Price Waterhouse, no changes were expected in the working relationship between Coopers & Lybrand and AHERF. Upon motion duly made and seconded, the Audit Committee recommended that the Board of Trustees of Allegheny Health, Education and Research Foundation consider the following resolution:

> RESOLVED, that the Allegheny Health, Education and Research Foundation Board of Trustees reappoints Coopers & Lybrand as independent auditors of AHERF and its subsidiary organizations for Fiscal Year 1998.

Adjournment

There being no further business, the meeting was adjourned at approximately 1:50 a.m.

Respectfully submitted

Nancy A. Wynstra

Nancy A. Wynstra, Esq.
Secretary

NAW:cg

c:\minutes\101597.aud

NOTED ATTACHMENTS: Notice of meeting; approved Fiscal Year 1997 Financial Statements and Related debt compliance letters; and Coopers & Lybrand Reports on AHERF Internal Controls.